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OPR paused amid weaker outlook

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Bank Negara taking a wait-and-see approach

ECONOMY

By GANESHWARAN KANA
ganeshwaran@thestar.com.my

PETALING JAYA: The surprise move by Bank Negara to not raise its interest rate is a strong signal about weaker economic conditions ahead.

The decision was made amid growing calls from businesses and households for the central bank to control borrowing costs and the fact that the country's unemployment and inflation rates are still higher than pre-Covid-19 levels.

Following the first Monetary Policy Committee (MPC) meeting for 2023 that ended yesterday, Bank Negara announced that the overnight policy rate (OPR) will be maintained at 2.75%, after it raised the benchmark rate by 100 basis points (bps) last year from 1.75%.

In an earlier poll by *Reuters*, all but one of the 27 economists had predicted Bank Negara would hike its OPR by 25 bps to 3% in January.

MIDF Research opined that Bank Negara is taking a wait-and-see approach to assess the market's performance.

"However, we believe the possibility for further normalisation of monetary policy remains, given that domestic economic data still showing an upbeat momentum.

"We expect a 25-bps rate hike in March 2023 and Statutory Reserve Requirement (SRR) normalisation," it said. It is noteworthy that the SRR was lowered by 100 bps from 3% to 2% effective March 20, 2020.

> **"(This is) perhaps with a view that the government's fuel and food subsidy regime is likely to stay broadly in place."**
> Wellian Wiranto

The SRR is an instrument to manage liquidity, whereby banking institutions are required to maintain balances in their statutory reserve accounts equivalent to a certain proportion of their eligible liabilities, this proportion being the SRR rate.

Meanwhile, OCBC Bank economist Wellian Wiranto said Bank Negara has indicated that growth concerns are starting to manifest more strongly, just as inflation risk has relatively subsided

"(This is) perhaps with a view that the government's fuel and food subsidy regime is likely to stay broadly in place," he said.

The central bank, in a statement yesterday, pointed out that the economic growth is likely to moderate in 2023 amid rising recession fears globally.

It also added that inflationary pressures would remain elevated this year, despite some moderation.

"Today's decision allows the MPC to assess the impact of the cumulative past OPR adjustments, given the lag effects of monetary policy on the economy.

"At the current OPR level, the stance of monetary policy remains accommodative and supportive of economic growth.

"Further normalisation to the degree of monetary policy accommodation would be informed by the evolving conditions and their implications to the domestic inflation and growth outlook," according to Bank Negara.

It also said that the MPC will continue to calibrate the monetary policy settings that balance the risks to domestic inflation and sustainable growth.

Bank Negara noted that the global economy continues to be weighed down by elevated cost pressures, higher interest rates and Covid-19-related disruptions in China.

These factors more than offset the support from positive labour market conditions, and the full reopening of economies and international borders.

With core inflation remaining above global historical averages, central banks are expected to continue raising interest rates, albeit at a slower pace, to manage inflationary pressures.

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Inflation remains manageable and containable

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This will continue to pose headwinds to the global growth outlook.

As for Malaysia, Bank Negara foresees the economy to come off a strong performance in 2022 to a more moderate growth in 2023.

However, it is not all doom and gloom for the Malaysian economy.

The central bank said growth will remain supported by domestic demand.

"Household spending will be underpinned by sustained improvements in employment and income prospects.

"Tourist arrivals have continued to rise, further lifting the tourism-related sectors.

"The realisation of multi-year infrastructure projects will support investment activity.

"Downside risks to the domestic economy continue to stem from a weaker-than-expected global growth, higher risk aversion in global financial markets amid more aggressive monetary policy tightening in major economies, further escalation of geopolitical conflicts, and re-emergence of significant supply chain disruptions," it said.

Meanwhile, over the course of 2023, headline and core inflation are expected to moderate but remain at elevated levels amid lingering demand and cost pressures.

Existing price controls and fuel subsidies, and the remaining spare capacity in the economy, will continue to partly contain the extent of upward pressures to inflation.

"The balance of risk to the inflation outlook is tilted to the upside and remains highly subject to any changes to domestic policy on subsidies and price controls, as well as global commodity price developments," according to Bank Negara.

Commenting on Bank Negara's monetary policy setting going forward, MIDF Research believes that its focus is to ensure a sustainable growth momentum of Malaysia's economy.

The research firm also expects the SRR to be raised to 3% this year.

"However, the decision will be subjected to the stability of economic growth, the pace of price increases and further improvement in macroeconomic conditions.

"This is particularly so for a continued recovery in the labour market and growing domestic demand.

"From a medium-term perspective, the policy rate normalisation is needed to avert risks that could destabilise the future economic outlook such as persistently high inflation and a further rise in household indebtedness," it said.

On domestic price pressures, MIDF Research said it is in the same tune with Bank Negara.

This was especially on the stance that the new government's fuel subsidy policy will determine the direction of Malaysia's inflation outlook for 2023.

"With the existing price controls and fuel subsidies, Malaysia's inflation remains manageable and containable," it said.

OCBC Bank's Wellian opined that Bank Negara is "very much ready to say bye-bye" to the OPR uptick cycle.

He said the central bank is acutely aware of the downside risks posed by external factors beyond its control.

"It is not that the central banks would no longer pay attention to lingering price pressure. It is just that, in life, everything is in relative terms.

"And within that rubric, growth concerns will start to dominate more and more going forward.

"Indeed, in the case of the more export-oriented Malaysia, growth worries have already tellingly superceded those on inflation," he added.